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DEPARTMENT PASS FOR UNDER SECRETARY BUCKLEY AND DAS NILES;
DEPARTMENT PASS USDOC FOR UNDER SECRETARY OLMER AND
ASST SEC BRADY; DEPARTMENT PASS DEFENSE FOR UNDER
SECRETARY IKLE; DEPARTMENT PASS TREASURY FOR ASST SEC
LELAND; DEPARTMENT PASS NSC FOR NORMAN BAILEY

FROM B DENYSYK, DAS/COMMERCE

E.O. 12065:RDS-1 3/22/02 (BARBOUR, ROBERT E.)

TAGS: EEWT, UK

SUBJECT: LUNCHEON DISCUSSIONS WITH UK DELEGATION
ON RESTRICTING CREDITS TO THE USSR.

1. SECRET ENTIRE TEXT.

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State Dept. review completed

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2. SUMMARY: DURING A LUNCHEON HOSTED BY LORD BRIDGES FOR PART OF THE U.S. DELEGATION (U/S BUCKLEY, U/S IKLE, U/S OLMER, A/S LELAND, R. BAILEY, DAS DENYSYK) THERE WAS A FRANK DISCUSSION ON THREE GENERAL ISSUES:

1) EVALUATION OF GERMAN AND FRENCH INTENTIONS ON RESTRICTING CREDITS, 2) RESTRICTION OF CREDITS TO THE USSR AND 3) DIFFERENTIATION BETWEEN THE USSR AND OTHER EUROPEAN COUNTRIES. LORD BRIDGES AND SOME OF HIS COLLEAGUES PROVIDED AN INVALUABLE POLITICAL EVALUATION OF FRANCE AND GERMANY. THEY COMMENTED THAT THE FRENCH GOVERNMENT IS HARD TO PREDICT BUT MAY GO ALONG WITH SOME RESTRICTIONS BUT THAT THE GERMANS WOULD PROBABLY RESIST. THEY ALSO POINTED OUT THAT RESTRICTING CREDITS TO THE SOVIETS SHOULD BE WEIGHED AGAINST SPILLOVER EFFECTS ON EASTERN EUROPE THAT COULD FORCE THEM CLOSER TO THE SOVIETS. CREDIT RESTRICTION COULD ALSO AFFECT COUNTRIES LIKE MEXICO. BRIDGES POINTED OUT THAT CREDIT RESTRICTIONS WOULD NOT DETER SOVIETS FROM MILITARY BUILDUP BUT U/S IKLE SAID THAT THE ALLIANCE MUST NOT ASSIST THE SOVIETS IN THAT BUILDUP AND COULD NOT SURVIVE ANOTHER TEN TO TWENTY YEARS IF THE PACE CONTINUES. THE BRITISH FELT THAT CURRENT MARKET AND POLITICAL FORCES ARE ALREADY DRYING UP CREDITS TO EAST EUROPE BUT THEY WILL EXAMINE TAKING SOME ACTION IN CONJUNCTION WITH THE U.S. END SUMMARY.

3. LORD BRIDGES, DEPUTY UNDERSECRETARY, FCO HOSTED A LUNCH ON MARCH 17, 1982 AT THE CARLTON GARDENS FOR PART OF THE U.S. DELEGATION. US ATTENDEES WERE U/S BUCKLEY, U/S IKLE, U/S OLMER, A/S LELAND, DR. NORMAN BAILEY (NSC), AND DAS DENYSYK. BRITISH ATTENDEES WERE JOE CAREY (U/S H.M. TREASURY), PETER CORLEY (U/S, DEPARTMENT OF TRADE), DONALD TUFORD (U/S, EXPORT CREDITS AND GUARANTEE DEPARTMENT), NIGEL BROOMFIELD, (HEAD OF DEPARTMENT - EAST EUROPE AND USSR), L. F. T. SMITH (BANK OF ENGLAND), AND LORD BRIDGES. THE LUNCHEON STARTED WITH CONVERSATION BETWEEN ADJACENT LUNCHEON PARTNERS BUT AFTER A SHORT WHILE LORD BRIDGES STOPPED THE SOCIAL CONVERSATIONS AND, IN ESSENCE, CONVENED A MEETING OVER LUNCH. FROM THAT POINT ON, THE DISCUSSION WAS STRUCTURED.

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4. THE LUNCHEON PROVIDED AN EXCELLENT OPPORTUNITY FOR CANDID AND FRANK DISCUSSION ON SEVERAL ISSUES. ALTHOUGH THE CONVERSATION DRIFTED FROM AREA TO AREA, THREE GENERAL ISSUES WERE ADDRESSED. THEY WERE: 1) EVALUATION OF FRENCH AND GERMAN INTENTIONS ON RESTRICTING CREDITS, 2) A GENERAL DISCUSSION ON RESTRICTING CREDITS TO THE USSR, AND 3) CONDUCTING A POLICY OF DIFFERENTIATION BETWEEN THE USSR AND OTHER COUNTRIES IN EASTERN EUROPE. DUE TO THE STRUCTURED NATURE OF THE LUNCHEON CONVERSATION AND THE COMMENTS IT WAS FELT THAT THE BRITISH WANTED TO GET A SENSE OF WHAT THE AMERICANS WERE "REALLY" AFTER AND TO OFFER SOME ADVICE.

5. BRIDGES STARTED THE DISCUSSION BY ASKING CORLEY TO EVALUATE FRENCH INTENTIONS ON RESTRICTING CREDITS TO THE USSR. CORLEY SAID THAT IT WAS DIFFICULT TO PREDICT THE MITTERAND GOVERNMENT, BUT IT WAS CLEARLY DIFFERENT FROM THE PREVIOUS ONE IN ITS ATTITUDE TOWARD EAST-WEST RELATIONS AND TRADE. ONE INDICATION IS FRANCE'S CONCURRENCE TO EC IMPORT RESTRICTIONS OF SOME USSR PRODUCTS IN RESPONSE TO THE POLISH SITUATION. CORLEY SAID THAT EVEN THIS MODEST RESPONSE WOULD NOT HAVE BEEN POSSIBLE UNDER THE PREVIOUS ADMINISTRATION. BRIDGES COULD NOT ISOLATE THE REASONS FOR THIS NEW ATTITUDE SPECIFICALLY, BUT THOUGHT IT WAS PART OF THE ATTEMPT TO SHOW THAT FRANCE HAD A RENEWED INTEREST IN THE ALLIANCE, AND DISARM THE GAULLISTS' CRITICISM THAT THE COMMUNIST MINISTERS WILL AFFECT MITTERAND'S STANCE VIS-A-VIS MOSCOW. BRIDGES POINTED OUT THAT MITTERAND WAS SUCCESSFULLY DISROBING THE FRENCH COMMUNISTS AND UNDERMINING THEIR POLITICAL BASE. THE RECENT CANTONAL ELECTIONS PROVED THAT MITTERAND'S STRATEGY \$\$\$

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SUCCESSFUL. BROOMFIELD AND CORLEY MENTIONED THAT THE FRENCH WILL PROBABLY BE FORTHCOMING ON THE CREDIT ISSUE BUT DID NOT VENTURE A GUESS AS TO "HOW FAR." THEIR ECONOMIC SITUATION "PREVENTED" THEM FROM GOING VERY FAR. LELAND ASKED IF THE BRITISH HAD A COPY OF THE FRENCH/SOVIET AND THE FRENCH/GDR TRADE PROTOCOLS. TWYFORD SAID THAT THEY DID AND WOULD TRY TO PROVIDE A

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COPY. CORLEY ADDED THAT A COUPLE OF YEARS AGO THE EAST GERMANS ASKED THE BRITISH TO SIGN A TRADE PROTOCOL THAT GUARANTEED CREDITS FOR PROJECTS COVERED BY THE AGREEMENT. THE BRITISH REFUSED. DURING THE WEEK OF MARCH 15, 1982, THE EAST GERMANS AGAIN BROUGHT UP THE ISSUE OF A TRADE PROTOCOL (DISCUSSIONS HELD IN LEIPZIG) BUT INSISTED THAT THEY DID NOT NEED A CREDIT GUARANTEE. THE GERMANS SAID THAT THEY COULD RAISE FUNDS EASILY. CORLEY COMMENTED THAT THIS PROVED THAT THE EAST GERMANS WERE WORRIED ABOUT THEIR CREDIT RATING.

IN CONCLUDING THE DISCUSSION ABOUT FRENCH ATTITUDES, BRIDGES REITERATED THAT THE FRENCH WOULD PROBABLY GO ALONG WITH SOME VERSION OF CREDIT RESTRICTIONS IF THE U.S. SHOWED IT WAS SERIOUS AND ENGAGED THE FRENCH TO HELP EVOLVE A WORKABLE SCHEME.

6. AS TO THE GERMANS, CORLEY COMPARED THEM TO PROMETHEUS BOUND TO A STONE WITH BIRDS PECKING AT THEIR ENTRAILS AND CLAIMING THEY COULD DO NOTHING. BRIDGES ATTRIBUTED THIS ATTITUDE TO SEVERAL DEVELOPMENTS. THEY ARE:

A) BRIDGES DID NOT THINK THAT THE SCHMIDT GOVERNMENT WOULD REMAIN IN POWER BEYOND THE END OF 1982. SCHMIDT'S RECENT ANNOUNCEMENT TO SEEK REELECTION IN 1984 CONFIRMS THIS.

B) THE FRG HAS A SPECIAL RELATIONSHIP WITH THE GDR. ALTHOUGH THEY WERE ONE OF THE LAST TO EMBRACE DETENTE, THEY TOOK OVER THE LEADERSHIP FROM THE FRENCH PARTIALLY TO INCREASE TIES WITH THE GDR. INITIALLY, THE FRG ATTEMPTED TO NORMALIZE RELATIONS WITH THE GDR DIRECTLY, BUT COULDN'T. AFTER GOING THROUGH MOSCOW, TIES WITH EAST GERMANY INCREASED. GOOD RELATIONS ARE POLITICALLY IMPORTANT IN THE FRG SINCE SEVERAL MILLION GERMANS ON BOTH SIDES OF THE WALL ARE AFFECTED.

C) SEVERAL INDUSTRIES (STEEL) IN THE FRG ARE HIGHLY DEPENDENT ON THE GDR. CORLEY POINTED OUT, HOWEVER, THAT THE GDR IS HIGHLY DEPENDENT ON THE FRG NOW WITH THE LEVERAGE TIPPING IN FAVOR OF THE WEST GERMANS.

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D) EAST-WEST TRADE SEEMS TO ENJOY BROAD POLITICAL SUPPORT IN THE FRG ALTHOUGH BRIDGES THOUGHT THAT A CDU OR CDU/FDP COALITION WOULD BE MORE FORTHCOMING ON THE CREDIT ISSUE.

BROOMFIELD MENTIONED THAT THE WEST GERMANS PRACTICE A HIGHLY DIFFERENTIATED POLICY BETWEEN THE USSR AND ITS SATELLITES. IT SEEMED THAT THE CLOSER A COUNTRY WAS TO THE ELBE RIVER, THE MORE PRONOUNCED THE DIFFERENTIATION. THE BRITISH SUPPORT THE DIFFERENTIAL APPROACH AND GENTLY WARNED US TO PROCEED CAUTIOUSLY ON CREDIT RESTRICTION LEST WE DRIVE THE EAST EUROPEANS INTO RUSSIAN ARMS.

IN SUMMARY, BRIDGES SAID THAT DUE TO INTERNAL POLITICAL UNCERTAINTY, THE ECONOMIC SITUATION, AND A LONG HISTORY OF GERMAN/RUSSIAN (STRETCHING WELL OVER 100 YEARS) TRADE TIES, IT WILL BE DIFFICULT TO GET THE GERMANS TO RESTRICT CREDITS. BUT HE SAID THAT IT COULD BE ACCOMPLISHED. THE BRITISH OFFERED TO HELP.

7. AS A GENERAL PROPOSITION, BRIDGES AGREED THAT THE WEST WAS SLIPPING INTO A REVERSE LEVERAGE SITUATION VIS-A-VIS EASTERN EUROPE. THE EAST'S HUGE DEBT WAS INFLUENCING THE ACTIONS OF THE LENDING NATIONS (FRG). CLEARLY, SOMETHING HAD TO BE DONE ABOUT THIS, BRIDGES THOUGHT THAT MORE STUDIES ARE NEEDED TO SHOW A CLEAR TIE BETWEEN RESTRICTING CREDITS AND THE MILITARY BUILDUP BEFORE A LONG TERM POLICY IS FORMULATED. HE CAUTIONED US TO PURSUE A LONG TERM POLICY AND NOT A SHORT TERM ONE SINCE WE WOULD EXPEND A LARGE AMOUNT OF POLITICAL CAPITAL FOR NAUGHT. CORLEY MENTIONED THAT THE STUDIES COULD SET THE FRAMEWORK FOR A RESTRICTED CREDIT POLICY THAT COULD HELP IN PERSUADING THE GERMANS TO CONFORM. THE GERMANS "LIKED CONCRETE" LINKAGES. THERE WAS GENERAL AGREEMENT THAT POLAND AND ROMANIA WERE NOT THE ONLY COUNTRIES IN ECONOMIC QUAGMIRE. BULGARIA, HUNGARY, AND CZECHOSLOVAKIA WERE NOT FAR BEHIND. BRIDGES MENTIONED THAT THEIR ANALYSIS SHOWED THAT SOME "HARD DECISIONS" OR DEFAULT IN POLAND MAY HAVE TO BE MADE WITHIN FIVE WEEKS. LELAND,

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NOTED, HOWEVER, THAT THE BIS BANKS COULD HANDLE EITHER A DE FACTO OR DE JURE POLISH DEFAULT OR EVEN A POLISH/ROMANIAN DEFAULT. BRIDGES NOTED THAT THE POLISH SITUATION HAD DISPROVED THE UMBRELLA THEORY WHICH HOLDS THAT THE USSR WOULD COVER THE DEBTS OF ITS SATELLITES, IF NEEDED. DURING DEFAULT PROCEEDINGS, CARE SHOULD BE TAKEN AS ISOLATE EASTERN EUROPE FROM THE USSR. LELAND POINTED OUT THAT YOU CAN'T SEPARATE THEM ECONOMICALLY BUT THAT POLITICAL DECISIONS COULD LIMIT THE DAMAGE (PROVIDING LOANS TO EASTERN EUROPE WHILE RESTRICTING CREDITS TO THE USSR). IN ADDITION, THE PROBLEMS FACING VARIOUS COUNTRIES IN EASTERN EUROPE ARE DIFFERENT IN CHARACTER. THE HUNGARIAN AND SOVIET PROBLEMS STEM FROM SHORT TERM LIQUIDITY PROBLEMS. BOTH COUNTRIES IMPORTED MORE THAN ORIGINALLY PLANNED WITHOUT ENOUGH HARD CURRENCY EARNINGS TO COVER THEM. THE HUNGARIAN PROBLEM IS COMPOUNDED BY THE USSR WITHDRAWING HARD CURRENCY ASSETS FROM HUNGARIAN BANKS CAUSING LIQUIDITY PROBLEMS. WITH A BETTER HARVEST NEXT YEAR AND ADDITIONAL GOLD SALES BY THE USSR, CORLEY FELT THAT BOTH COUNTRIES ECONOMIC PROBLEMS COULD BE SOLVED. U/S IKLE DISPUTED THIS BY NOTING THAT STRUCTURAL PROBLEMS WITHIN THE USSR (PRODUCTIVITY FLAT, GROWTH NEAR ZERO, DECLINING HARD CURRENCY EARNINGS, ETC.) HERALD LONG TERM ECONOMIC PROBLEMS. IN ADDITION TO STRUCTURAL PROBLEMS IN EASTERN EUROPE, THERE EXISTS A MAJOR UNKNOWN: THE ARABS. VARIOUS OIL-RICH ARAB COUNTRIES HAVE DEPOSITED HARD CURRENCY IN EAST EUROPEAN BANKS. IF THEY WITHDREW ALL OR PART OF THOSE FUNDS IN THE NEAR FUTURE, SEVERE LIQUIDITY PROBLEMS WOULD RESULT WITH THE POSSIBILITY OF MASSIVE DEFAULTS. BAILEY SUGGESTED CONSULTATIONS WITH THE ARABS, BUT THE BRITISH SAID THAT THE CONSULTATIONS THEMSELVES COULD SPOOK THE ARABS AND TRIGGER WITHDRAWAL.

THE BRITISH INFORMED THE US DELEGATION THAT THEY ARE NOT EXTENDING ANY CREDIT NOW TO ROMANIA AND POLAND. THIS SITUATION IS UNLIKELY TO CHANGE IN THE NEAR FUTURE. NO CREDIT NOW FLOWS TO THE USSR WITHOUT COVER (A

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SIMILAR SITUATION EXISTS IN THE FRG; THE COVER PROVIDED IS ALL OFFICIAL. LLOYD'S AND OTHER PRIVATE INSURANCE COMPANIES ARE NO LONGER PROVIDING POLITICAL RISK INSURANCE. DURING THE CREDIT DISCUSSION, BRIDGES ASKED WHAT WERE U.S. LONG TERM GOALS FROM THIS EXERCISE TO RESTRICT CREDITS TO THE USSR. U/S BUCKLEY ANSWERED BY SAYING THAT WE WERE NOT TRYING TO AFFECT SOVIET POLICY.

WE WERE SIMPLY TRYING TO FORCE TRADE WITH THE SOVIETS TO EXIST ON PURE COMMERCIAL TERMS RATHER THAN GOVERNMENT SUBSIDIZED OR GUARANTEED BASIS. THIS GOVERNMENT INTERVENTION IN CREDITS IS HELPING THE BUILDUP OF THE SOVIET MILITARY MACHINE. THE SOVIETS SHOULD BEAR THE COST OF THIS BUILDUP BY THEMSELVES AND NOT WITH NATO OR JAPANESE ASSISTANCE. U/S IKLE THEN ADDED THAT IF LEFT UNABATED, NATO WOULD NOT BE ABLE TO MATCH SOVIET BUILDUP FOR THE NEXT TEN TO TWENTY YEARS THEREBY THREATENING ITS VERY EXISTENCE. BRITISH REACTION TO THIS COMMENT WAS GENERALLY POSITIVE BUT CERTAINLY LOW KEY. THE THRUST OF THE BRITISH COMMENTS WERE THAT RESTRICTING CREDITS WOULD NOT ALTER THE SOVIET BUILDUP EXCEPT PERHAPS ON THE MARGIN. U/S OLMER NOTED THAT EVEN THIS WAS WORTH PURSUING ESPECIALLY WHEN THE U.S. AND OTHER COUNTRIES ARE TAXING THEIR CITIZENS TO INCREASE DEFENSE PREPAREDNESS. THE BRITISH STRESSED THAT ADDITIONAL STUDIES OF THE SOVIET ECONOMIC VULNERABILITIES ARE NECESSARY AND PERHAPS THE WASHINGTON CONFERENCE ON CREDITS COULD BE USED TO DISCUSS SOVIET ECONOMIC PROBLEMS.

8. TOWARDS THE END OF THE LUNCHEON DISCUSSION, THE BRITISH REINFORCED THEIR POSITION ON DIFFERENTIATION. THEY STRESSED THAT THE WEST SHOULD CREATE CONDITIONS THAT ALLOW THE SOVIET BLOC COUNTRIES TO EVOLVE POLITICALLY AND LOOSEN THEIR TIES TO THE USSR. WHILE THIS GOAL WILL CERTAINLY BE DIFFICULT TO ATTAIN AND WILL TAKE A LONG TIME, IT IS WORTH PURSUING. PRESENTLY THE SOVIETS ARE FORCED TO MAINTAIN A HIGHER STANDARD OF LIVING AND ALLOW CERTAIN POLITICAL AND ECONOMIC LIBERTIES IN EASTERN EUROPE THAT THEY DO NOT ALLOW IN THE USSR. AS AN EXAMPLE, BRIDGES CITED THE HUNGARIANS. THE ECONOMIC STRUCTURE AND STANDARD OF LIVING STANDARDS

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IN HUNGARY APPROACH THOSE OF SOME WESTERN COUNTRIES. IT HAS TAKEN TIME TO EVOLVE TO THIS POINT AND THE WEST SHOULD TAKE POLITICAL DECISIONS TO SUPPORT THIS EVEN TO THE POINT OF PROVIDING CREDITS WHEN EXPECTATIONS RE- PAYMENTS ARE LOW. THE U.S. DELEGATION IN PRINCIPLE, AGREED WITH THIS APPROACH. U/S IKLE POINTED OUT, HOWEVER, THAT THE SOVIETS ALLOW ONLY A CERTAIN AMOUNT OF DEVIATIONS FROM THEIR PICTURE OF COMMUNISM; 1953, 1956, 1968 AND 1981 PROVE THIS. BRIDGES NOTED HOWEVER, THAT THESE

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DEFENSES OF THE SOVIET EMPIRE HAVE NOT STOPPED POLITICAL AND ECONOMIC EVOLUTION AND THEY EXPECT ADDITIONAL CHANGES IN THE SOVIET BLOC. U/S OLIVER NOTED THAT TO PURSUE A DIFFERENTIAL POLICY, IT IS DOUBLY IMPORTANT TO RESTRICT CREDITS TO THE USSR ITSELF. THIS APPROACH WOULD PROVIDE THE POLITICAL CLIMATE TO PROVIDE ASSISTANCE TO EASTERN EUROPE. OTHERWISE, POLITICAL FORCES WITHIN THE U.S. WOULD FORCE A TOTAL CUTOFF OF CREDITS TO THE SOVIET BLOC. THE BRITISH AGREED THAT A TOTAL CUTOFF WOULD BE COUNTER-PRODUCTIVE.

9. THE LUNCHEON PROVIDED A USEFUL FORUM FOR A FRANK AND CANDID EXCHANGE OF VIEWS BETWEEN LONG TIME ALLIES. I SENSED THAT OUR MESSAGE WAS CLEARLY UNDERSTOOD BY THE BRITISH AND WILL CONVEY IT TO THE FRENCH AND GERMANS. TODMAN

END OF MESSAGE

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